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# STATEWIDE ISSUES

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## A Fundamental Review of State Government

California government is filled with skilled and dedicated men and women, but without focused leadership State agencies have been left to drift instead of serving the public most effectively. The California Performance Review will be a comprehensive examination of what government does and how it is done. Led by people that understand the problems government faces firsthand, the Performance Review will transform state government and energize the bureaucracy so that they provide the best services to the public in the most efficient way.

California has a procurement acquisition system so laden with process that it can take years to complete purchases that can and must be completed within months. Acquisition processes need a complete overhaul so they make good business sense for the state. California state government has largely missed the productivity gains and service improvements that the private sector secured in the 1990s through the aggressive application of information technology to support basic business operations. Government must join the 21<sup>st</sup> century.

The result of the California Performance Review will be a leaner government, a better provider of services, and an organization that takes advantage of the talents and abilities of everyone within state government. This will restore the public's full trust and confidence in government and fulfill our promise to make government work for all Californians.

The California Performance Review will build upon earlier efforts to reform and reinvent government. However, this review will focus on specific, tangible reforms in each area of government operations rather than moving boxes around on an organizational chart. The implementation of the Performance Review will recognize that state government has a special obligation to serve the public. While there are lessons to be learned from the private sector, government can never be just another business.

Piecemeal reform is not enough; instead fundamental change is necessary from top to bottom.

To address these truly fundamental governance issues, the Administration will establish the California Performance Review. The initiative has four major components:



- 1. Executive Branch Reorganization—**  
The State will restructure the Executive Branch of government to make decision-making in the branch more responsive to the public's needs and interests and make government operations more transparent, manageable, and cost-effective.
- 2. Program Performance Assessment and Budgeting—**The State will implement a program to make regular, detailed, and rigorous evaluations of program performance (focusing on prioritization of program needs, return on program investment, and effective program management) and will make program elimination or modification decisions and budget decisions that reflect those evaluations.
- 3. Improved Services and Productivity—**  
The State will pursue a customer-focused transformation of government operations to provide convenient, responsive, and cost-effective services, benefits, and information to the public. In addition, the State will replace duplicative and conflicting financial, human resources, and procurement management systems with a common set of modern systems that are interoperable across all departments in state government. A Constitutional amendment to allow for competition in government through outsourcing opportunities will provide one of the necessary tools for reform.
- 4. Acquisition Reform—**The State will overhaul its acquisition program significantly to improve the quality and timeliness of its acquisitions. Best practices used by the federal government, other states, and the private sector will be examined and adopted as appropriate to secure the best values in State acquisitions.

The leadership and energy to make these reforms happen can be found both inside and outside of government. There are a handful of people in America that possess the experience with a performance review of this magnitude and they have agreed to be a part of the outside team that will train and manage 125–150 senior career managers, borrowed from within the state government bureaucracy, to conduct this review.

The Administration will also form the California Performance Review Commission, which may consist of legislators, business men and women, representatives from local government, other Constitutional Officers, and other interested parties. The Commission will provide counsel, advice, and conduct public hearings to get input from the general public on the current performance of government operations and ways to improve that performance.

## Improving Accountability and Service Delivery

Executive Order S-4-03 instructed departments to disencumber non-essential contracts and purchase agreements funded by the General Fund where the goods and services have not been received. At this time, it is estimated that \$50 million of one-time General Fund savings could be achieved.

### Key Findings— Charging Encumbrances

- Certain encumbrances seem to take an excessive period of time to liquidate and may tie up funds for a longer period of time unnecessarily.

In addition to canceling current encumbrances, the Department of Finance will convene a work group of selected departments and other control agencies in January to review current practice, statutes, and regulations to determine the timing and appropriateness of charging an encumbrance. Currently, most budget act appropriations for support and local assistance are active for three years. During the first year, the appropriations are available for expenditure and encumbrance. Then two years are provided for liquidation of encumbrances existing as of the end of the first year. The objective of the review is to consider changes to minimize the time between encumbrance recognition and the receipt of goods and services resulting in more timely realization of unused appropriation amounts.

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### **Fraud, Waste, and Abuse**

Since taking office, the Governor has received numerous suggestions from the public, legislators, and advocacy groups regarding specific areas of fraud, waste, and abuse in state government. Some of these are identified as key findings in this document. In order to take a systematic approach to this review, the Department of Finance staff will be tasked with investigating potential fraud, waste, and abuse in state government. Findings will be reported by May 1, 2004, and savings proposals will be submitted at this time.

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## **Employee Compensation**

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### **Function of Employee Compensation**

The goal of the State's employee compensation program is to provide a reasonable and competitive package of salary and benefits so the State can attract and maintain a competent workforce without unduly burdening the

taxpayers of California. For most employees, this is accomplished through collective bargaining conducted pursuant to the State Employer-Employee Relations Act. The State currently has approximately 160,000 employees represented through 21 bargaining units, plus approximately 35,000 employees who are classified as managers, supervisors, or confidential employees who are not covered by collective bargaining.

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### **Improving Accountability and Service Delivery**

As the current contracts expire, this Administration will bargain on behalf of the taxpayers of California to create a compensation package that is reasonable without extravagances adopted by the previous Administration. The Administration sees the greatest opportunity for improving accountability through reforming the State's retirement programs.

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## **California Public Employees' Retirement System**

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### **Function of CalPERS**

The CalPERS administers retirement and health benefits for more than 1.4 million past and present employees for State and local agencies in California. Most State employees participate in a defined benefit retirement system that will guarantee them monthly re-



## Key Audit Findings—Employee Compensation

- For most State employees, cessation of employees' 5 percent contribution to the California Public Employees' Retirement System (CalPERS), plus credit for one day of additional leave time each month, plus credit for a 5 percent higher salary base for determining retirement benefits, were all provided so the employees would delay by one year the effective date of a scheduled 5 percent salary increase.
- Since California Highway Patrol officers do not contribute to their retirement, they could not receive cessation of the employees' 5 percent contribution to CalPERS that most employees received above. To provide the officers with a benefit that offered a similar economic value, a special pay provision was provided that will compensate the officer's half hour lunch at time and a half.
- The Department of Forestry and Fire Protection (CDF) is in the third year of a five-year contract. Increases to planned overtime were included as part of this contract. During a firefighters normal 72-hour stay at the fire station, 24 hours are scheduled as normal work time (base salary) and 19 hours are scheduled as planned overtime. Before the contract, planned overtime was paid at half of the base salary hourly rate. Planned overtime will increase as follows for the term of the contract:
  - In 2003-04, planned overtime will be paid at three-fourths of the base salary.
  - In 2004-05, planned overtime will be paid at the base salary.
  - In 2005-06, planned overtime will be paid at 1 1/2 of the base salary.
  - In 2006-07, planned overtime will be paid year-round instead of only during the fire season. In summary, by 2006-07, firefighters will be getting paid 1 1/2 of their base salary year-round for planned overtime.

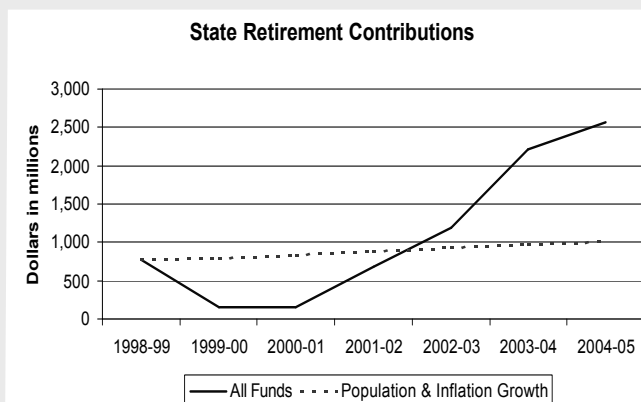
tirement benefit stipends for life based upon final compensation, age at retirement, and years of service; there are different formulae for each of the retirement categories (such as safety members, industrial members, police officers, and firefighters, etc.). While some employees pay a fixed percentage of their salaries into the retirement system, the State pays the preponderance needed to ensure that the retirement system remains actuarially sound.

## Improving Accountability and Service Delivery

Under the previous Administration, retirement benefits for State employees were significantly improved with the enactment of Chapter 555, Statutes of 1999 (SB 400). Most State employees can currently retire at age 55, and enjoy a retirement calculation under which their benefit will be the number of years of service multiplied by 2 percent, with the product of this calculation multiplied by the employee's highest salary for 12 consecutive months. Prior to SB 400, the same employee

### Key Audit Findings— Public Employees' Retirement System

- Under the State's current retirement benefits, most employees who retire at age 55 with 35 years of service can enjoy a monthly retirement check that is 70 percent of their salary for the remainder of their life. For some employees, the benefits improve to ensure lifetime retirement payments, which are 90 percent of pay while working if they retire at age 50 after working only 30 years.
- In 1999-00, the State's contributions to the retirement system were approximately \$160 million. Since that time the State's contributions to CalPERS for State employees has skyrocketed to more than \$2.1 billion in 2003-04, more than 13 times the contribution made four years ago.
- The pension obligation bond that was proposed for the current year was simply a way to delay the State's annual contribution, rather than part of a long-term restructuring of pension benefits.



### General Fund Savings (Dollars in Thousands)

| Year         | State Contribution Without Pension Reform Package | Increased Employee Contributions | New Employee Benefit Change | Pension Obligation Bond Proceeds | Debt Service on Pension Obligation Bonds | State Contribution With Pension Reform Package | Annual Savings from Pension Reform Package |
|--------------|---|----------------------------------|-----------------------------|----------------------------------|--|--|--|
| 2004-05      | \$1,361,871                                       | -\$13,882                        | -\$6,415                    | -\$929,450                       | \$0                                      | \$412,125                                      | \$949,746                                  |
| 2005-06      | 1,398,331   | -19,226                          | -17,077                     | -19,506                          | 55,835                                   | 1,398,358                                      | -27  |
| 2006-07      | 1,435,768   | -27,850                          | -35,688                     | 0                                | 57,007                                   | 1,429,237                                      | 6,531                                      |
| 2007-08      | 1,474,207   | -43,960                          | -72,285                     | 0                                | 57,007                                   | 1,414,969                                      | 59,238                                     |
| 2008-09      | 1,513,675   | -41,536                          | -82,219                     | 0                                | 57,007                                   | 1,446,927                                      | 66,748                                     |
| 2009-10      | 1,554,199   | -39,589                          | -149,263                    | 0                                | 98,020                                   | 1,463,368                                      | 90,832                                     |
| 2010-11      | 1,595,809   | -37,416                          | -172,425                    | 0                                | 98,882                                   | 1,484,851                                      | 110,958                                    |
| 2011-12      | 1,638,533   | -35,366                          | -195,245                    | 0                                | 98,882                                   | 1,506,804                                      | 131,728                                    |
| 2012-13      | 1,682,400   | -33,431                          | -217,774                    | 0                                | 98,881                                   | 1,530,076                                      | 152,323                                    |
| 2013-14      | 1,727,442   | -31,604                          | -240,062                    | 0                                | 98,882                                   | 1,554,657                                      | 172,784                                    |
| 2014-15      | 1,773,689   | -29,881                          | -262,155                    | 0                                | 98,882                                   | 1,580,536                                      | 193,153                                    |
| 2015-16      | 1,821,175   | -28,253                          | -284,100                    | 0                                | 98,882                                   | 1,607,704                                      | 213,471                                    |
| 2016-17      | 1,869,932   | -26,717                          | -305,941                    | 0                                | 98,882                                   | 1,636,156                                      | 233,776                                    |
| 2017-18      | 1,919,995   | -25,266                          | -327,721                    | 0                                | 98,881                                   | 1,665,888                                      | 254,107                                    |
| 2018-19      | 1,971,397   | -23,897                          | -349,483                    | 0                                | 98,881                                   | 1,696,898                                      | 274,499                                    |
| 2019-20      | 2,024,176   | -22,604                          | -371,268                    | 0                                | 98,882                                   | 1,729,186                                      | 294,990                                    |
| 2020-21      | 2,078,368   | -21,382                          | -393,116                    | 0                                | 98,881                                   | 1,762,751                                      | 315,617                                    |
| 2021-22      | 2,134,011   | -20,229                          | -415,066                    | 0                                | 98,882                                   | 1,797,598                                      | 336,413                                    |
| 2022-23      | 2,191,143   | -19,139                          | -437,157                    | 0                                | 98,882                                   | 1,833,729                                      | 357,415                                    |
| 2023-24      | 2,249,805   | -18,110                          | -459,428                    | 0                                | 98,881                                   | 1,871,148                                      | 378,657                                    |
| <b>Total</b> | <b>\$35,415,928</b>                               | <b>-\$559,337</b>                | <b>-\$4,793,886</b>         | <b>-\$948,956</b>                | <b>\$1,709,220</b>                       | <b>\$30,822,968</b>                            | <b>\$4,592,960</b>                         |



would have been required to be 60 years old before enjoying this generous formula. Similar improvements were made for all other State employees' retirement categories.

SB 400 was passed in part because it was not expected to have an immediate effect on the amount of the State's annual contribution. When the Legislature adopted SB 400, the stock market was still at historically high levels and CalPERS had a substantial surplus. CalPERS assured the State that the retirement system had a sufficient surplus to absorb the cost of the increased retirement benefits for nine years, or until 2009. Substantial investment losses that the retirement system suffered from 2000 through 2002 make that assurance unsupportable.

In the fiscal environment for the foreseeable future, the State can no longer afford the current retirement program without a reduction in benefits or an increase in employees' contributions toward the benefits. Beginning in 2004-05, the State will be pursuing two strategies to control the State's costs for pension benefits. Because the State's existing workforce has already made financial decisions based upon the commitment of the post-SB 400 retirement formulae, the State will be seeking to increase employees' annual retirement contributions by 1 percent of their gross pay rather than change retirement benefits. In most cases this increase will be from 5 percent to 6 percent. For most new employees who have had no expectation of a specific retirement formulae, the State will be pursuing legislation to return to the pre-SB 400 formulae.

In order to realize immediate benefits from these reforms, the State will be seeking new pension obligation bonds to pay a portion of its pension contributions until the effect of returning to the pre-SB 400 benefit levels is sufficiently recognized in CalPERS' actuarial projections.

Beginning in the third year of this reform proposal, the savings in annual General Fund contributions to CalPERS will more than offset the annual debt service for the pension obligation bond and will continue to grow each year thereafter. Over the next 20 years, these changes are expected to save the General Fund \$4.6 billion.

The table on the previous page compares the State's expected General Fund costs for retirement with General Fund costs after reforms. For example, in 2009-10 the current retirement program would cost \$1.6 billion, from the General Fund (\$2.8 billion all funds) but after adjusting for savings of \$39.6 million from increased employee contributions, \$149.3 million from new employee benefit changes and costs of \$98 million for debt service on pension obligation bonds, the annual savings from the pension reform package would be \$90.8 million.

Even after these changes, the State's retirement package will be extremely generous and will allow State employees to retire earlier than many private-sector employees. In addition, State employees will continue to be secure in the knowledge that a volatile investment market will not affect retirement benefits because they will continue to be covered by a defined benefit retirement plan; this is in stark contrast to the concerns of many private sector employees. As a way to save money and provide employees with more flexibility, the private sector has generally opted away from defined benefit retirement plans and instead provides defined contribution plans. Under a defined contribution plan, the employer provides either a set amount or matches a percentage of the employee's contribution to an employee's retirement account. The employee often determines how these funds are invested. The employer does not guarantee a retirement benefit, so the

risk that investments will not return sufficient gains to adequately fund the employee's retirement is borne by the employee.

## Health and Dental Benefits for Retired Annuitants

### Functions of Health and Dental Benefits for Retired Annuitants

Since 1962, the State has provided its retirees with continuing health care coverage similar to the health care coverage for active employees. Dental coverage was added as a continuing benefit for retired annuitants in 1982. These benefits are considered to be "vested," so current employees as well as retired annuitants will continue to receive them. Generally, the State's contribution toward these costs is the combination of the total average premium cost for the employee, and 90 percent of the average premium cost for dependents.

### Program Enhancements and Other Budget Adjustments

The Governor's Budget proposes an increase of \$195.3 million in 2004-05 based on both premium and enrollment growth. The Administration will continue to examine ways to reduce future health care benefit costs.

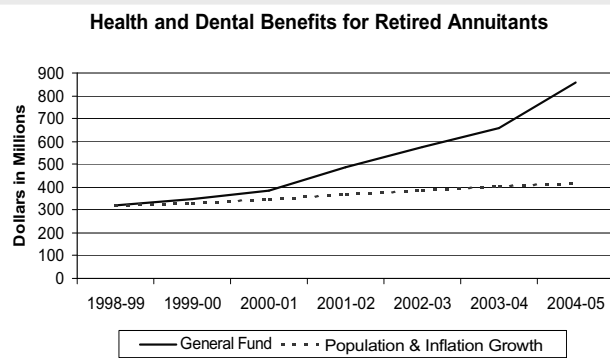
## State Teachers' Retirement System

### Functions of the State Teachers' Retirement System

The State Teachers' Retirement System (STRS) provides retirement-related benefits and services to certificated teachers in public schools from kindergarten through the community college system. There are approximately 430,000 active and 150,000 retired members of STRS. Members contribute 8 percent of their salary and school districts, as the employer, contribute 8.25 percent of the employees' salary for the defined benefit program. The State also contributes 2.017 percent of teachers' salaries toward the defined benefit program.

### Key Audit Findings—Health and Dental Benefits for Retired Annuitants

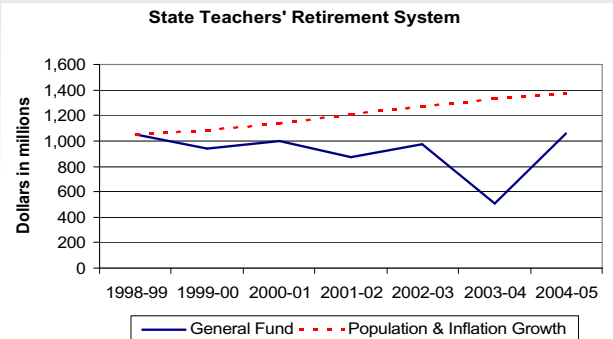
- The Budget Act of 2003 provides a total of \$661 million from the General Fund to pay for health and dental benefits of retired state employees. This is an increase of \$343 million (or 108 percent) above the 1998 Budget Act. The reason for the substantial increase in cost since 1998-99 is due to increases in the number of state retirees and large increases in health care premium costs.





## Key Audit Findings—State Teachers' Retirement System

- The 2003-04 Supplemental Benefit Maintenance Account contribution was reduced by \$500 million by Chapter 6, Statutes of 2003, First Extraordinary Session (SB 20X), which made a statutory commitment to restore the funds, with interest, if purchasing power protection cannot be maintained at the 80 percent level through July 1, 2036.
- The Supplemental Benefit Maintenance Account was established in 1990 to ensure that retired teachers' pension payments would maintain at least 68.2 percent of their original purchasing power, with the purchasing power "floor" being raised to 75 percent in 1998 and then to 80 percent in 2002. Over the same period, the State's contribution for this benefit has increased from 0.5 percent of teacher payroll to 2.5 percent of teacher payroll.



and 2.5 percent of teachers' payroll toward the Supplemental Benefit Maintenance Account (SBMA).

### Program Enhancements and Other Budget Adjustments

**Benefits Funding**—Pursuant to Education Code Section 22955, the State contributes annually 2.017 percent of teacher payroll for Benefits Funding. The Governor's Budget proposes to increase funding for Benefits Funding by \$21 million as a result of an increase in teacher payroll.

**SBMA**—The SBMA augments annuitant retirement payments to provide 80 percent purchasing power protection. Purchasing power protection benefits are cost-of-living adjustments intended to maintain the retiree's current retirement benefit at a percent of the original benefit at retirement in constant dollars. Pursuant to Education Code

Section 22954, the State contributes annually 2.5 percent of teacher payroll to the SBMA.

The Governor's Budget proposes to increase funding for the SBMA by \$526.1 million, \$26.1 million as a result of an increase in teacher payroll and \$500 million to reflect that the 2003-04 \$500 million reduction was a one-time action.

## Contracting For Services

### Improving Accountability and Service Delivery

In November 2000, the voters of California recognized the imprudence of the restrictions on contracting for architectural and engineering services when they added Article XXII to the Constitution. The Administration will be pursuing a new Constitutional amendment to expand Article XXII to permit the

**Key Audit Findings—  
Contracting for Services**

- The Constitutional provisions establishing the State's civil service system have been interpreted by the Courts to severely limit the State's ability to contract with non-State entities to provide ministerial function even when doing so could improve services, improve efficiency or, in some cases, reduce costs.

State to contract with non-State entities for ministerial functions whenever doing so will reduce costs, improve efficiency, or improve services. The Governor's Budget anticipates that the electorate will once again recognize the prudence of contracting for services when appropriate by including General Fund savings of almost \$1 million that will result from contracting out food services for the State's developmental centers.

